DOW THEORY LETTERS INC.

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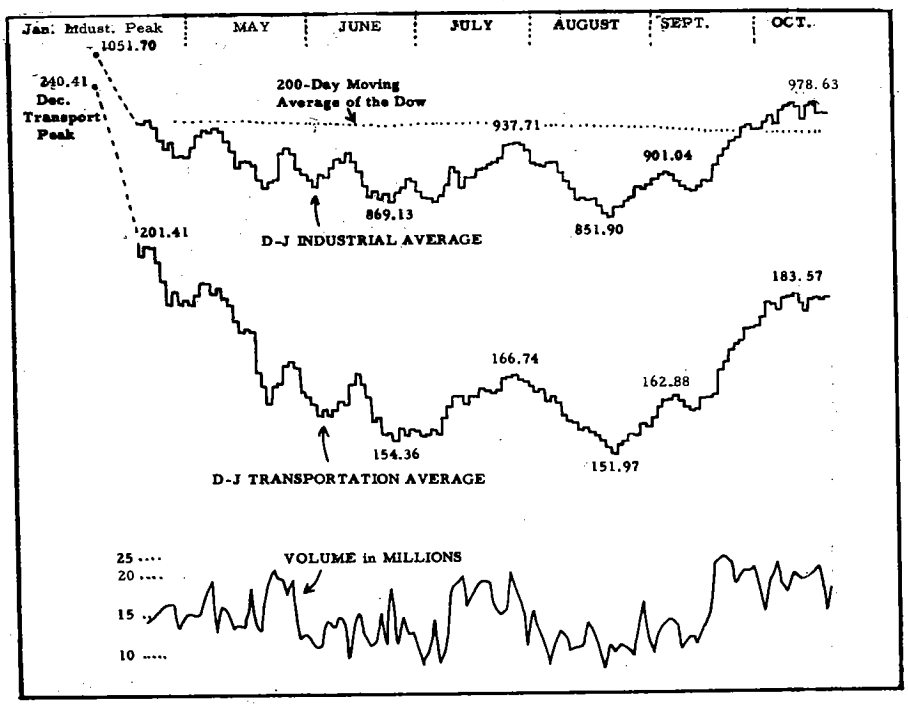
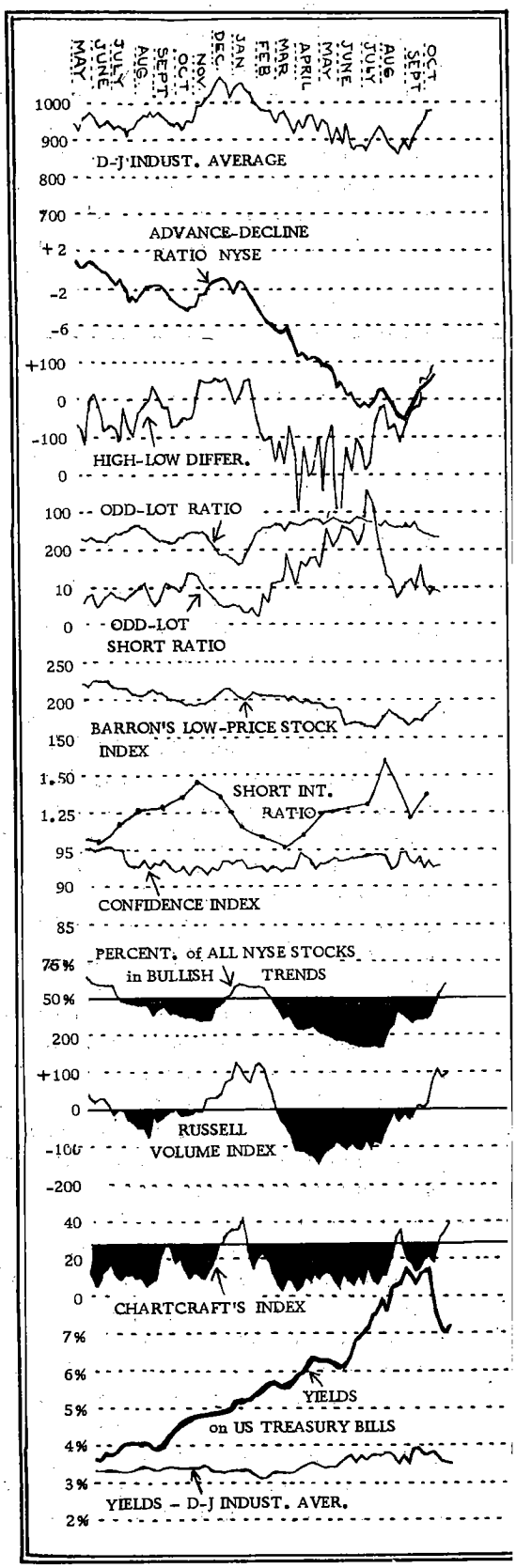
Oct. 5, DJIA 971.25; PTI 725; A-D ratio -11.86
Oct. 12, DJIA 978.63; PTI 736; A-D ratio -11.61

THE PICTURE: According to the London Economist's latest statistics, their international commodity index is up 59% over year ago figures (based on percentage change at annual rates). The D-J spot commodity index is up 92%, while the D-J future commodity index is up 83%. What's happening? For one thing, we are nearing what one economist termed the "gathering clouds of resource shortage." And chasing the resources is a widening ocean of paper money. Inflation is running rampant throughout the world, and those who are familiar with history know that when this has happened before, inflation has run its terrible course. No legislation, no warnings, no adjustments will end the inflationary rampage. In the late stages of the Roman Empire, the emperor Diocletian invoked the death penalty in certain instances where unsanctioned price rises were involved. Yet even this did not stop the fall of the Roman currency nor the fall of Rome itself. Inflation will continue to exhaustion, then topple of its own weight. The citizen must simply protect himself as best he can.

If there is an "unconscious" working behind the movements of the stock market (and I think there is), it has been saying throughout most of 1973 that the powers which run this nation would not tolerate any more wildfire inflation, they would not tolerate any further deterioration in our currency, they would not allow the American dream to turn into a nightmare. In discounting the stern government measures which "had" to be taken, the market sagged lower from January to July.

At that point, the market began to understand that as far as the US was concerned, "nothing was going to be done." The high interest rates broke, the





 Federal Reserve Board shifted to a "softer" stance, prices continued to rise, and many spoke of letting prices seek their own level. The stock market was (after July) daring to act on what the cynics knew only too well; the government would ultimately prove totally impotent to deal with the situation.

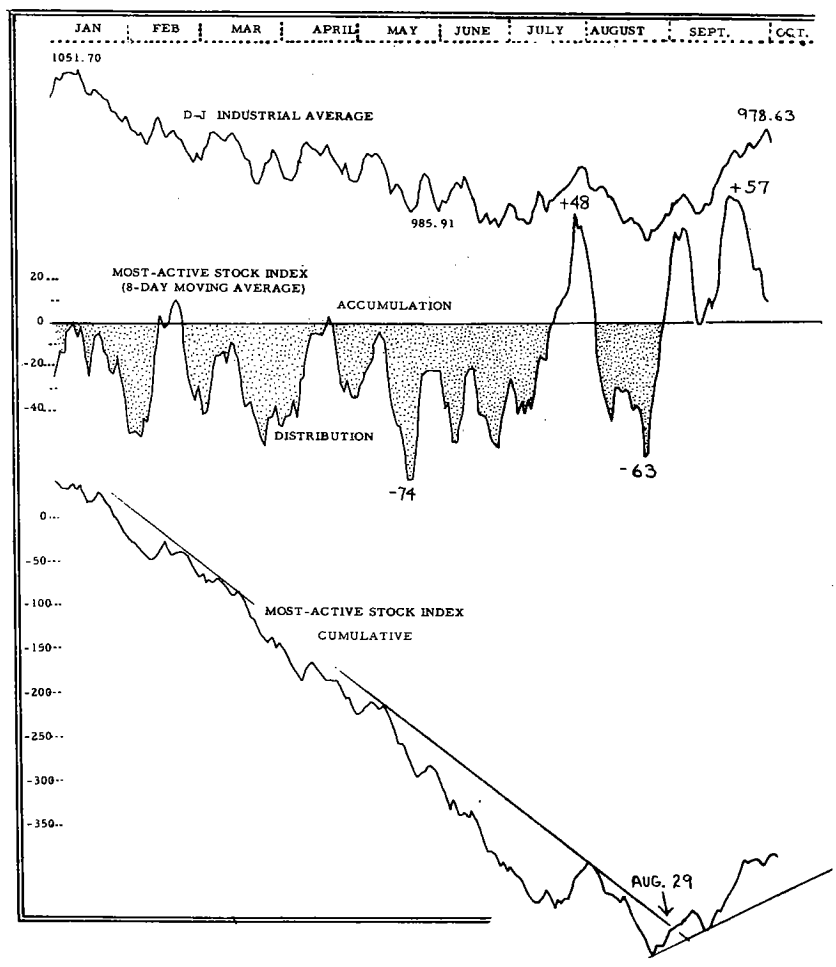
In less than two months the D-J Industrial Average rocketed up from 851.90 (August 22) to the October 12 peak of 978.63. Applying my ruler to the angle of ascent on my ratio chart, I can see that the August-October rally qualifies as the steepest of any of the bear market rallies since February, 1966 (that date marking the top for the whole 1949-66 primary bull market).

As usual, the Averages did provide their warning of potential danger, although this warning was subtle indeed. On October 8 the Transportation Average recorded a 1973 peak of 183.57 (see page 1 chart). Four trading days later Industrials rose to a 1973 high of 978.63, but the new Industrial high was not confirmed by Transports. High volume accompanied the non-confirmation, and on October 15 the market sold off sharply.

Since February, 1966, there have been five downward sweeps (by the Dow) from the 1000 zone and five upward corrections (against the primary bear trend). The latest upward correction, the one starting from the August lows, possessed a "fury" all its own. It has been a veritable Roman Candle with all the fire and sparks that go with it. But finally the market was caught in a period of churning exhaustion, then depressed by a Mid-East conflagration which has the potential to shake the world.

I have always subscribed to the thesis that the Averages discount everything (excepting acts of God), and I therefore do not like to mix news events with market movements. Nevertheless, it seems obvious that both Mr. Kissinger and the stock market have been taken by surprise by the Mid-East war. As of now, no one (and I certainly include myself) appears to know how "bad" the war will be, how it can be settled, and what terms an ultimate settlement might entail. Because of the economic (oil) implications of the war, it also seems probable that major stock market fundamentals will be involved. Therefore, I am wondering whether the market will be truly altered in the course it was taking, and whether this war implies that it is "a whole new ball game."

I am including a chart of two of the technical indicators which I have found to be outstandingly useful for predictive purposes. These are my two "most-active stocks" indices. Both are based on the daily plurality of the 15 most-active stocks on the NYSE. For instance, if on a given day 12 stocks advance and 3 decline, the daily plurality would be plus 9. The MAS is an oscillating index, or an 8-day moving average of the daily pluralities. The CMAS is a cumulative index of the pluralities, with each day's plurality added or subtracted to a running total (like an A-D index of the pluralities).



Note on the chart that MAS, by holding stubbornly to the minus side, showed distribution in the most-actives all during January to early-July, 1973. Then on July 25 MAS registered plus 48 (accumulation), prior to plunging to minus 63 during the money-crunch sell-off. From the minus 63 of August 21, MAS again improved dramatically. On August 29 the cumulative index (CMAS) gave its upward or bullish signal by reversing a trendline which had held a bearish stance all year. With both most-active indices in the bullish position, the market rallied in earnest. On September 25 MAS recorded a plus 57, the highest figure of which I have any record. From that point on, I suspected increasing profit-taking and distribution (see Letter 576, page 2).

The MAS index is now clearly in a corrective phase, and it will be most important to note whether it bounces around zero or thrusts deep into negative territory. The longer-term implications for the market will be gauged by CMAS, however. If CMAS breaks its current rising trendline I would consider it ominous. A new low on this cumulative index would, I feel, imply that the primary bear trend of the market had once again taken hold. Conversely,

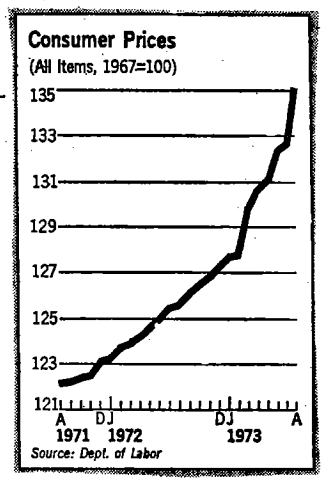
it is well to note that CMAS has much latitude on the upside before it breaks its rising trendline. It would therefore be well to consider the secondary trend bullish as long as the most-recent (or rising) trendline on CMAS holds intact.

HISTORIC SHIFT OF POWER: I have been warning for a number of years that the West and more particularly the US is compounding a series of horrendous mistakes. Because of these mistakes, the center of world power is shifting. Gold, I stated, is the international thermometer, and gold moves towards power just as power accumulates gold.

As World War II ended, the US had roughly $25 billion in gold. By 1965 the US gold stock had dropped to $14 billion. By 1971 the US gold stock (which was by then mortgaged four times over via foreign claims against it) had dropped to $10 billion. On August 15, 1971, faced with a run on the dollar and on the remaining US gold, President Nixon closed the "gold window." Had the US been a private corporation, that action would have been tantamount to declaring bankruptcy. Instead of facing the problems and implications of the critical gold-monetary picture, the US preferred to lie to itself by implying that a fiat dollar "float" was just what the doctor ordered. Students of history knew better.

Here, in very brief form, are a few of the great mistakes which I believe the US has made since World War II. (1) Attempting to buy the world's favor via huge, in many cases totally inefficient, handouts of dollars. (2) Expenditures of billions of dollars in a vain attempt to stop all forms of communism. (3) Giving away and selling billions of dollars worth of arms to almost any nation who promised to "oppose communism." (4) Continuing interference with free markets and the processes of supply and demand. (5) Establishing huge, bulit-in spending plans in the US, spending plans which were never properly funded (for instance, social security, welfare, medical care, armaments. (6) Massive deficit spending by government, which encouraged similar wild deficit spending among US citizens, all of which kept the fires of inflation blazing. (7) Squandering of natural resources with little or no plans or policies for conservation.

The results of these policies are now breaking out into the open. Here are some of the results as I see them. (1) A long, torturous primary bear market in securities with the Dow holding in the 650-1050 area since 1966, even while billions of dollars were pumped into the economy. This succeeded in producing the biggest and most inflationary boom in US history. (2) A continuing loss of US monetary reserves, to the point where the "bargain-priced" US dollar is now available in such huge quantities that it is still near its floor in world exchanges. (3) A loss of prestige for the US throughout the world, as its currency becomes "unwanted" and inconvertible. Anger around the world as US exports dollars, which results in world inflation and disgust with greenbacks (a collapsing "reserve currency"). (4) Flagrant inflation in the US and throughout the world, with the US consumer squeezed as retail prices climb relentlessly upward (see chart). (5) An accelerating shift of the world financial center from New York to the Mid-East, probably Saudi Arabia. Over the next three years, Saudi-Arabia is expected to accumulate $50 billion in foreign exchange reserves, perhaps $100 billion by 1980. (Saudi Arabia is increasing its exchange reserves at the rate of $100-200 million a month; its oil income next year should reach $15 billion!).



I wrote a few months ago that the US must (1) Get into reality and fast, via coming to grips with its economic problems or (2) Learn what it means to be humble, because at the rate we are going humility is going to be thrust upon us. Our acceptance of inflation, our fiat currency-anti-gold stance, our arrogance, our dream-like Vietnam war policy, our wild deficit spending, all these factors are coming together like trendlines which converge. Bernard Baruch was fond of saying, "Two and two always equals four." That's a lesson which the US will be fated to learn shortly (although perhaps in an unexpected way).

GOLD: Now I want to present a section which may be the most important that I have written this year. It has to do with what I believe is the coming "unwinding" of the gold and monetary story. First I want to say that in order to unravel any market mystery one needs (1) information, (2) some talent, (3) lots of energy, (4) an obsessional quality known as one-mindedness, (5) a bit of artistry. At this time I want to thank all those readers who have sent me information, clippings, insights and assorted help, subscribers from every continent and from around the world. At any rate, this is what I see happening on the gold-monetary front, and it is a fabulous story.

The IMF is "finished." The Nairobi safari brought down the curtain on the whole farce. Listen to this from the latest report (at Nairobi) by my very good friend, Harry Schultz (PO Box 1161, Basel 14002, Switzerland). Harry pulls no punches when he says, "Chances of reform are nil. There was no attempt to negotiate at Nairobi...Despite inflation, each nation can afford to say, you go your way, we'll go ours, if they disagree...We must await slump, perhaps depression, trade wars and severe hardship, which will then compel nations to form a workable system." This, says Harry, guarantees "chaos ahead," currency instability, crises, great risks. "Gold will soon end its seasonal decline about the same time people realize that the IMF talk about a lesser gold role was hot air." One sentence from C.V. Myers (Myers' Finance & Energy, PO Box 5531, Calgary,

 Alberta, Canada T2H 1X9), who also attended the Nairobi meeting, indicates that C.V. and Schultz viewed the situation at the IMF in about the same dim light. "I have never, in all my life, seen so many clowns in one place," writes Myers.

On October 15 Douglas Johnston of Texas (see last Letter) sent me an amazing AP dispatch. Excerpts: "The Common Market Monetary Committee has reached a consensus that it is time to substantially increase the credits available to support the joint float of Common Market currencies...The Committee, composed of high officials from Common Market Ministries and central banks, was preparing its opinion on proposals by the Common Market Commission to multiply sixfold on January 1 — to some $10 billion — the existing amount of Common Market short-term credits and on the same date pooling reserves, with 20% of each members holdings...The formal opinion would be ready for Common Market finance ministers, who are due to meet Oct. 29 and 30 to consider the Commission's proposal along with other ideas for moving into a second, more constraining phase of economic and monetary union."

Now we turn to the very recent S. African symposium on monetary affairs in which Dr. Milton Gilbert, economic adviser to the Bank of International Settlements (the BIS is the union of hard money nations where I believe the next actual monetary agreements will be made — see last Letter) stated that the Common Market nations would shortly be using gold to settle accounts inside the common market, and gold priced close to the free market price. Furthermore, said Gilbert, if the US does not get going it is going to find itself facing a European economic bloc. "As an international civil servant and as an American," said Gilbert, "I would be depressed by this prospect."

What does it all mean? Douglas Johnston puts the story together in the same way I do. Europe gave up on the US at the Nairobi meeting. Europe is giving up on the dollar as a reserve currency. Europe realizes that it will have to develop its own currency bloc, to which the US may be invited to join. A new system is to be launched by the EEC, and a new gold backed currency or group of currencies will be in the offing. But if the new system is to supply EEC needs, the reserve base will have to be expanded greatly, and it will have to have a solid foundation in gold. But I'll let Johnston "spill the beans," and following is the text of a letter I just received from Doug along with the AP clipping.

"Dear Dick, Here it comes — clear as a bell, if you know what you've been looking for. How do you multiply reserves six fold? By making gold official at $210 (Russell's note: six times the 'official' $42.22 price is roughly $210). My guess is that they'll do it in two stages. (1) Declare that the EEC central banks can buy or sell gold at the free market price (or about $100). (2) Then move the 'market' up to $210 in 1974. Regards, Doug."

So there it is, the extraordinary story that sounds logical, sounds as if it is going to happen, and sounds as though it is going to work. This story has not been published anywhere, and if true, it should give us our final major rise in gold and the gold shares, the rise which I have indicated was coming under my Elliot wave studies in previous Letters.

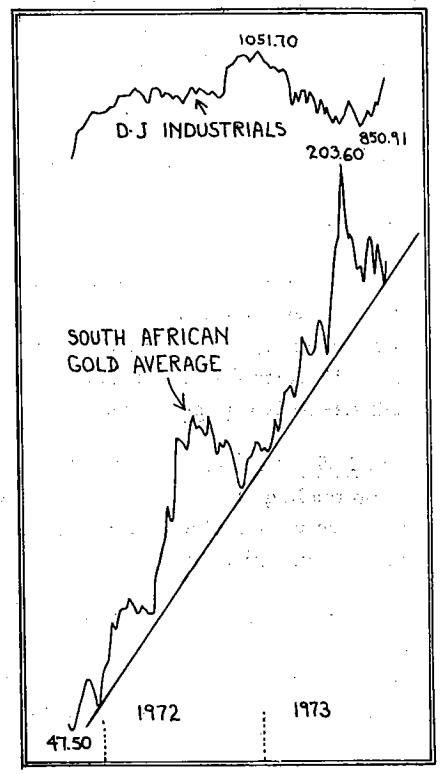
What of the inflationary implications of such a European move? The new gold price could be inflationary if the various nations decide not to keep fixed percentages of reserve in gold. But note at the end of the AP story that the EEC is to discuss a "second, more constraining phase of economic and monetary union." A new, higher priced gold base could allow for inflation, but proper constraints would take care of that (plus the real will to fight inflation).

How does the Arab situation fit into all this? The Arab oil nations are up to their ears in dollars. They want other currencies, gold. Europe is worried to death about any possible Arab cut in European oil supplies. A new, gold-backed European currency would suit the Arabs just fine. But a fiat dollar is intriguing the Arabs less and less. If Europe moves to a gold-back currency, the Arabs could put terrific pressure on the US to join the whole arrangement. If not, the Arabs could say, "Look, we're selling our oil to Europe for a hard currency. Why should we sell you our oil for fiat dollars, particularly when we are already up to our ears with dollars?" Need I say more?

Those of my subscribers who have been patient and who have allowed the primary trend to "work" for them continue to do well with current positions. I have stated that the great primary trend of the stock market is bearish (despite any and all upward corrections), and that the primary trend of the Gold Group is bullish. My position has been that subscribers should assume a diversified portfolio of gold shares and hold the golds until the primary trend in the Gold Group runs to completion. I have not advocated trading gold shares, because it is the nature of a primary bull movement to periodically "shake out" the weak hands and the faint hearted.

Although I do not usually recommend trading secondary (upward corrections) in a bear market, I did suggest trading positions in the current rally in a few of the strongest Dow stocks. This is the first time I have "OK'd" such positions, and I did it on the basis of the historical six consecutive months of decline in the Dow Industrial Average, and on the very heavily oversold situation in the market. Now the market has about expended its oversold status, and I have much less inclination to recommend retension of even strong Dow stocks at this time. One reason is that I feel that recommended issues such as Alcoa and International Paper have provided generous profits for traders and that they are considerably less attractive here. The second reason

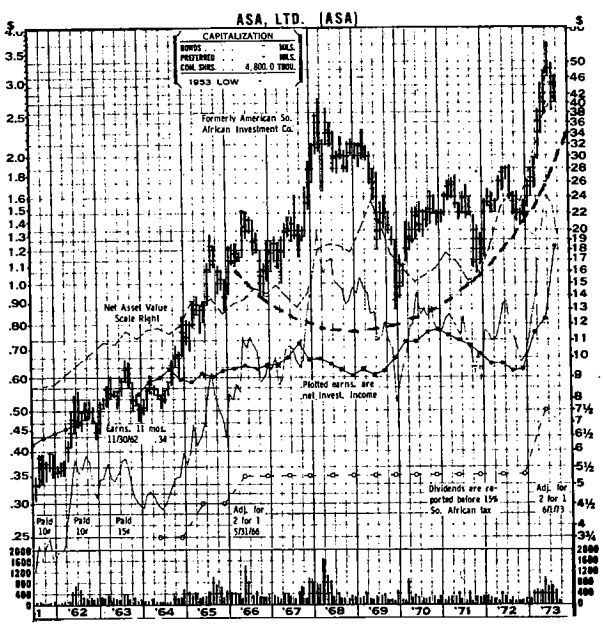
is that I feel that the gold shares have almost completed their bases following the recent corrections, and that they may be purchased for portfolios which are in need of additional gold shares and for new readers who do not own any golds.



As a point of interest for older subscribers, current statistics show the following: The S. African gold index (see Barron's) has risen from a 1972 year-end 95.90 to the latest 154.50, which means that the Kaffirs (S. African gold shares) on average are up 62%. Barron's own Gold Stock Average has risen from a year-end 145 to the current 251, a rise of 73% (both of these gold indices thus show major appreciation, even allowing for the recent correction in golds). As a comparison, the Lipper Index of 534 All-Funds (mutual funds) shows a loss of 10.09% for the year so far while the Lipper Index of 333 Growth Funds shows a loss of 13.44%. For those of us who invest with the primary trend, the events of 1973 have so far vindicated our positions.

The technical picture for the golds is becoming quite interesting. My daily gold bullion chart (London second fixing price) broke upside out of a large triangle on October 8. I repeat again that large interests seem willing to accumulate all gold offerings at $100 or under. On the week ending October 12 the S. African gold index (figures from Barron's) bounced off its long, rising trendline and headed higher.

I include a semi-log or ratio chart of the S. African Index and the Dow, so that percentage comparisons can be made. Note the bounce off the trendline on the S. African Index. My guess would be that this index will probe new high ground during 1974 as gold holds steady around the $100 level but as the gold shares move up to discount the new higher price which I see coming. The S. African Gold Index (as reported daily on the D-J broad tape) has formed a good rounding bottom, and it has been pushing up nicely over the past few days. At 172, the Canadian Gold Average has completed a "head-and-shoulders" bottom, and this too confirms the thesis that the period of gold share correction and accumulation is drawing to a close. Finally, my 13-week momentum charts of Campbell and Dome have just turned up for the first time since June, and relative strength on Dome appears about ready to break out on the upside.

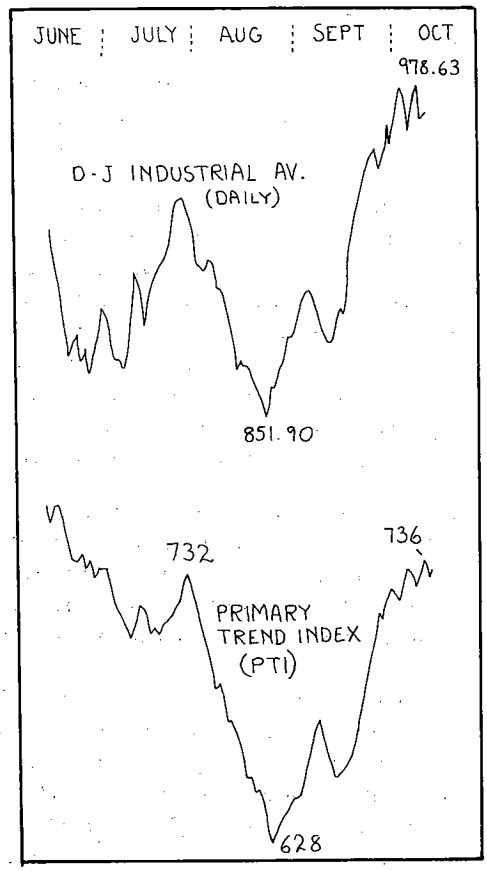


For those who have not purchased any gold shares or who wish to add to holdings, I recommend ASA, Campbell, Dome, and Homestake on the NYSE, and ADR's in West Dreifontein, Kloof, Vaal Reefs, and Blyvoors. Rumor has it that Elsburg and Western Areas are planning a merger, and many of my subscribers have both of these.

George Fugler of Performance Index (PO Box 145, Linthicum Hts., MD 21090) makes the remarkable observation that "It may come as a distinct shock to you dyed-in-the-wool Growth Cultists — more so if you are some sort of anti-gold 'barbarous relic' proponent, but ASA has outperformed IBM by better than 2 to 1 over the past 10 years." I include a monthly chart of this stock and I have applied a bottom arc as drawn with a French curve (a favorite pastime of mine). I feel that this stock is in a great-arc sweep up, a sweep which began gathering momentum during 1969-71. The most speculative and spectacular part of the rise could be ahead (note the implications of the long-term movements vs. the frustration and puzzlement of the short-term action). At a Friday (Oct. 19) closing of 43, ASA would reverse its corrective declining trendline, and this too could signal the beginning of the new upward gold-share move. (Chart of ASA courtesy of Security Research, 208 Newbury St., Boston, MA 02116).

LATE OBSERVATIONS: On October 17 Transports appeared to be pushing through their October 8 peak of 183.57 (see page 1 chart). Now it will take an Industrial rally above the October 12 high of 978.63 for a new Industrial confirmation. This see-saw action is not as satisfactory as simultaneous confirmation on the upside and implies some distribution — but no danger as yet.

I show on this page a chart of the daily action of the Dow and my PTI, which as older readers know, is a composite daily indicator that takes a reading on eight critical technical indices. Both the Dow and the PTI have touched new recovery peaks over the past few days, and if there is trouble ahead it does not show here yet. Note that the PTI has bettered its own July peak, thereby confirming the Dow. The action of the PTI during the Mid-East war has been very impressive, no question about it. The PTI has provided excellent indications on a trendline analysis, and so far no trendlines have been broken.

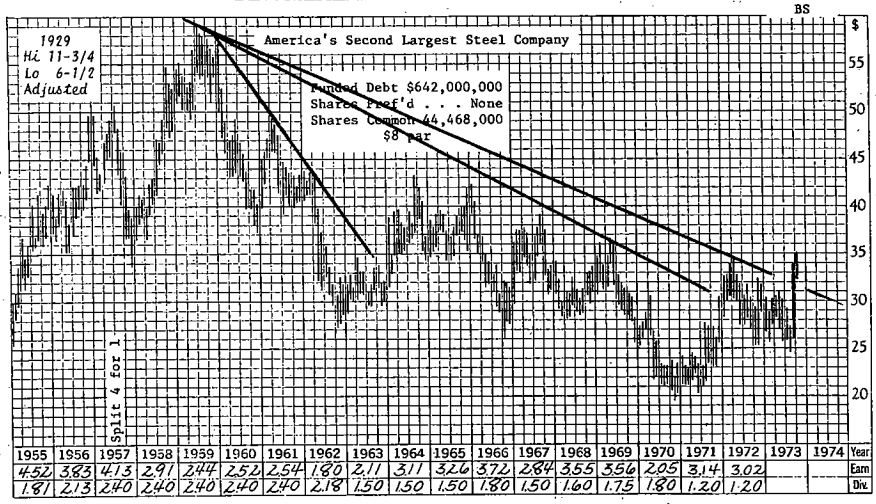


I wrote last week that I would present a study of momentum on the Dow. I simply do not have room here for the study but the Dow is now at the top of its 13-week momentum cycle, and I expect any rise from here to lack the momentum of the Dow rise since August. Based on past momentum performance, I would expect this rise to last no more than another two months before running into trouble.

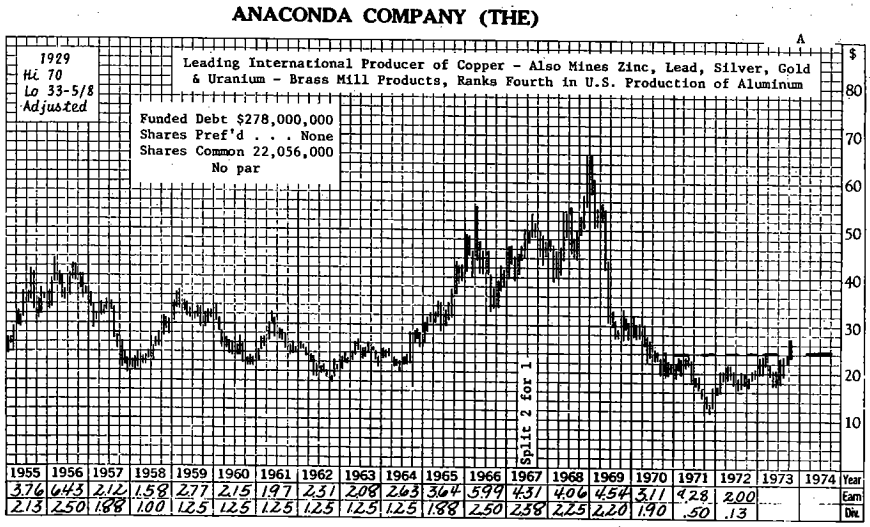
STOCKS: Based on my technical studies, there is one Dow Industrial stock with a top reading of 5 (on a zero to five scale) and that is Int. Paper. In the strong 4 category are Allied Chemical, Alcoa, DuPont, Int. Nickel, Owens-Illinois and Esmark, plus the two shown on the charts on this page.

These two monthly charts show much back history, which is important here (charts courtesy of Horsey, Salisbury, MD 21801). The metals are showing some of the first signs of life in years, and that certainly is one outstanding facet of this market. In the old days it was said that "the metals are the last to move," and that could be what we are seeing. At any rate, note that Bethlehem Steel has now reversed three long-term trendlines, and at its current position it appears that a good base has been established — and that "Bessie" is now out of that base. The long-term group relative strength chart on Steels is now bullish, and it will be interesting to watch BS from here. I view it as one of the more interesting speculations.

BETHLEHEM STEEL CORPORATION ★



ANACONDA COMPANY (THE)



I talked quite a bit about Anaconda over the past year, and it never did really make the move. The coppers are also bullish on a long-term relative strength basis, and Anaconda now is well over the 19-20 area at which I first called attention to it. As you can see, their base is now completed, a base which formed following the disastrous 1969-71 collapse. With copper prices sky-high, Anaconda could make alot of money in 1973 and 1974. Of course, the market knows this too, which accounts for its really good rally of late. Nevertheless, I like Anaconda for the bold traders.

For the record, Dow stocks with zero ratings on my scale are American Brands, Kodak and Proctor and Gamble.